STATE OF MICHIGAN
IN THE SUPREME COURT
Appeal from the Michigan Court of Appeals
Murphy, C.J., Fitzgerald, Borrello, J.J.

DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,
STATE OF MICHIGAN,

Defendant-Appellant.
_____/

Supreme Court No. 148753

Court of Appeals No. 309732

Court of Claims No. 10-104-MT

BRIEF ON APPEAL OF APPELLANT MICHIGAN DEPARTMENT OF TREASURY

ORAL ARGUMENT REQUESTED

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Dated: November 24, 2014

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STATEMENT OF JURISDICTION

This Court has jurisdiction under MCR 7.301(2) and the Court's order of October 1, 2012, granting Treasury's application for leave to appeal.

STATEMENT OF QUESTIONS PRESENTED

The industrial processing exemption to the Use Tax Act exempts from taxation "property sold to . . . (a) an industrial processor for use or consumption in industrial processing," MCL 205.94o(1)(a), but explains that "industrial processing does not include the following activities: . . . (b) sales, *distribution*, warehousing, [or] *shipping* . . . ." MCL 205.94o(6)(b). The questions for this Court are as follows:

1. Whether property used in the transmission and distribution of electricity qualifies for the industrial processing exemption when "distribution" and "shipping" are specifically excluded from the definition of "industrial processing" and a longstanding promulgated rule states that "property . . . . used in the transmission or distribution of electricity . . . . is taxable." Mich Admin Code R 205.115.

   Appellant's answer: No.

   Appellee's answer: Yes.

   Trial court's answer: Yes.

   Court of Appeals' answer: Yes.

2. Whether, if the exemption applies, MCL 205.94o(2) requires an apportionment between taxable and exempt use based on a "reasonable formula or method approved by the department."

   Appellant's answer: Yes.

   Appellee's answer: No.

   Trial court's answer: No.

   Court of Appeals' answer: No.

STATUTES AND RULES INVOLVED

MCL 205.94o

(1) The tax levied under this act does not apply to property sold to the following after March 30, 1999, subject to subsection (2):

(a) An industrial processor for use or consumption in industrial processing.

****

(2) The property under subsection (1) is exempt only to the extent that the property is used for the exempt purpose stated in this section. The exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department.

(3) Industrial processing includes the following activities:

(a) Production or assembly.

****

(d) Inspection, quality control, or testing to determine whether particular units of materials or products or processes conform to specified parameters at any time before materials or products first come to rest in finished goods inventory storage.

****

(4) Property that is eligible for an industrial processing exemption includes the following:

****

(f) Machinery, equipment, or materials used within a plant site or between plant sites operated by the same person for movement of tangible personal property in the process of production. Property exempt under this subdivision includes front end loaders, forklifts, pettibone lifts, skidsters, multipurpose loaders, knuckle-boom log loaders, tractors, and log loaders used to unload logs from trucks at a saw mill site for the purpose of processing at the site and to load lumber onto trucks at a saw mill site for purposes of transportation from the site.

****

(5) Property that is not eligible for an industrial processing exemption includes the following:

(a) Tangible personal property permanently affixed and becoming a structural part of real estate in this state including building utility systems such as heating, air conditioning, ventilating, plumbing, lighting, and electrical distribution, to the point of the last transformer, switch, valve, or other device at which point usable power, water, gas, steam, or air is diverted from distribution circuits for use in industrial processing.

****

(6) Industrial processing does not include the following activities:

****

(b) Sales, distribution, warehousing, shipping, or advertising activities.

****

(7) As used in this section:

(a) "Industrial processing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail. . . . Industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage.

(b) "Industrial processor" means a person who performs the activity of converting or conditioning tangible personal property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. . . .

****

Mich Admin Code R 205.115 (Rule 65)

****

(3) The sale of tangible personal property is not taxable when consumed or used in the process of manufacturing or generating electricity, gas, or steam which is taxable when sold at retail. Transformers used in industrial processing are not taxable.

(4) The sale of tangible personal property consumed or used in the transmission

or distribution of electricity, gas, or steam is taxable. Such transmission or distribution starts at the place where the product leaves the immediate premises from which it is manufactured.

****

Mich Admin Code R 205.90 (Rule 40)

(1) This rule applies to sales, purchases and rentals of tangible personal property to persons for use or consumption in industrial processing, and the word "sales" hereafter used shall be construed to be either sale, purchase or rental. The word "manufacturing" as used in this rule is included within those activities which are considered "industrial processing."

(2) "Industrial processing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination or character of the property for ultimate sale at retail or use in manufacturing of a product to be ultimately sold at retail.

(3) The sale of tangible personal property to manufacturers, which property becomes an ingredient or component part of the finished product or that which is consumed, destroyed or loses its identity in a manufacturing process, together with the processing machinery and equipment (including maintenance and repairs thereof) used in the manufacturing of a product which is either to be sold ultimately at retail or to be used as tangible personal property in the manufacture of a product to be sold ultimately at retail, is not taxable. The consumption or use of the tangible personal property rather than the kind or character of the property sold is the determining factor as to whether or not such a sale is taxable. The industrial processing exemption does not include:

(a) Tangible personal property permanently affixed and becoming a structural part of real estate. This includes building utility systems such as heating, air conditioning, ventilating, plumbing, lighting and electrical distribution. Example: all electrical transmission and distribution materials and equipment which are installed in the construction of plant facilities for, or by, an industrial processor for use in transmitting electrical energy is taxable up to the last transformer, switch or other device at which point usable power is diverted from distribution circuits for use in industrial processing.

****

(h) Tangible personal property used or consumed for the preserving or maintaining of a product in the form and condition in which it is to be sold.

(4) The following examples of nontaxable sales illustrate the application of the industrial processing exemption:

(a) Property which becomes an ingredient or component part of the finished product to be sold ultimately at retail.

(b) Machinery, tools, dies, patterns, machinery and equipment foundations and other processing equipment, including repair and maintenance of all of these, used in an industrial processing operation.

(c) Property which is consumed, destroyed or loses its identity in a manufacturing or other production process.

****

(f) Machinery, equipment and materials used within a plant site for movement of tangible personal property in process of production.

****

(5) Industrial processing includes the following activities:

(a) Production.

****

(g) Production material handling.

(6) Industrial processing does not include the following activities:

****

(b) Sales, distribution, warehousing, shipping and advertising departments.

****

(7) The foregoing examples of taxable and exempt activities shall not be considered as exclusive in either category but are included as generally descriptive of industrial processing operations which are considered exempt as distinguished from nonexempt activities.

(8) Where the industrial processing areas or spaces are not separate and distinct from other departments or activities, or where the same tangible personal property can be used or consumed in the industrial processing area and 1 or more other areas, the tax will apply to such property unless it can be determined and substantiated to the satisfaction of the revenue division, department of treasury that a percentage or other apportionment thereof is equitable and practical.

INTRODUCTION

This case asks whether sending electricity along a transmission line from a generating station to a consumer is an industrial processing activity (as Detroit Edison argues) or a distribution activity (as Treasury concludes). It is the latter, because *even if* the transmission of electricity along power lines were to meet the general definition of industrial processing, MCL 205.94o(7)(a), "distribution" activities are specifically excluded from the industrial processing exemption, MCL 205.94o(6)(b). In short, because the specific controls over the general, Detroit Edison's transmission activities do not fall within the exemption.

The industrial processing exemption is a sales-and-use-tax exemption allowed for specified manufacturing activities that is written in generic terms applicable to the diverse range of Michigan industries. In contrast to some sales and use tax exemptions, it was not written with a specific industry or taxpayer in mind. Instead, its terms are intended to apply equally to the manufacturing process across the economy.

The statute's plain language in § 94o(6)(b) expressly excludes the activities of both "distribution" and "shipping" from "industrial processing." Applying these terms to the electricity industry, the transmission and distribution of electricity is a type of "distribution" and "shipping" activity, which the Legislature did not intend to treat as industrial processing.

Detroit Edison has claimed that the "transmission and distribution" of electricity *is* manufacturing, relying on technical arguments about the nature of electricity and some processing activities that occur while the electricity is being

sent along transmission lines. But the Legislature in passing the general rule did not address the specific nature of electricity; instead, it relied on generally applicable language. And in the plain meaning, conveying electricity along transmission lines is a distribution activity. Electricity is *produced* at the generation facilities. But the primary purpose of all equipment used in transmission and distribution is efficiently distributing it to the customer.

The Court of Appeals' opinion eschewed this plain language, instead carving out a broad exemption uniquely applicable to electric utilities by claiming that this factual scenario was outside of the generic terms used by the Legislature. But creating an exemption for a specific fact pattern is a task for the Legislature, not a court. And allowing a unique carve-out violates the rule that exemptions must be strictly construed for the very reason the rule was enacted: to discourage special treatment for a particular taxpayer and to equally apportion the tax burden among taxpayers.

The Court of Appeals' other errors also warrant reversal. First, it refused to apply Rule 65, an APA-promulgated legislative rule written *specifically* to address the unique features of utilities, by incorrectly characterizing it as a non-binding interpretive policy statement. Mich Admin Code R 205.115(4). Second, the Court, relying on outdated case law that has been overturned by statute, gave Detroit Edison a complete exemption, instead of following the statute's express requirement of apportioning between taxable and exempt use. MCL 205.94o(2).

For all of those reasons, and those discussed more comprehensively below, Treasury respectfully requests that this Court overrule the Court of Appeals' January 9, 2014 opinion in entirety and hold that (1) the transmission and distribution of electricity is not "industrial processing" under MCL 205.94o; and (2) Rule 65 is binding and enforceable and precludes the exemption sought. Alternatively, Treasury asks the Court to hold that any exempt use must be apportioned and that such a claim has been waived by Detroit Edison's failure to propose an apportionment to both Treasury and the trial court.

STATEMENT OF FACTS

I. Detroit Edison's operations

Detroit Edison is an electrical utility that sells electricity to industrial, commercial, and residential customers. (App 197a). For each of these types of customers, the voltage of electricity that constitutes "usable" or "consumable" electricity can vary depending on the individual operations of the customer. (App 215a, ¶ 113; App 229a, ¶ 65-66; App 172a, 77:8-21 (indicating that "some large industrial user" may be able to use electricity at 138,000 volts)).

Detroit Edison generates electricity at several generating plants located throughout Michigan. (App 208a-210a, ¶ 41-42, & 62; App 172a, 75:5-6 (noting "power is generated from your generator")). Electricity is produced by converting fuels such as coal, oil, or natural gas into heat that boils water to form steam and turn the turbines shafts. (App 210a, ¶ 63-66). As the shafts turn, a coil of wire on the generator rotates with the shaft around a coil fixed to the generator, creating a

magnetic field and inducing current in the fixed coils. (App 210a, ¶ 67-70). The produced current is electricity. (App 210a, ¶ 71); (App 152a, ¶ 18).

The electricity generated at the plants is produced at a voltage of approximately 15,000 volts. (App 210a, ¶ 72; 220a). However, in order to transmit and distribute the electricity across the electric system to its customers, Detroit Edison steps up the voltage to anywhere between 115,000 to 500,000 volts as the electricity leaves the plant. (App 211a, ¶81; App 235a, ¶ 26).

The voltage is increased in large part because "it is more efficient, practical and safer to transmit electricity at a high voltage and low current, rather than a low voltage and high current . . . ." (App 211a, ¶ 79). A utility could generate and transmit power at 120 volts but does not do so for both efficiency and cost reasons. (App 179a at 102:1-104:7). Transmitting electricity at a higher voltage minimizes "power loss" and "thus maintains the same level of electric power" throughout the system. (App 221, ¶ 28-30; App 172a at 75:12-24; App 152a, ¶ 21 (noting that "[t]he addition of voltage is for the purpose of reducing electrical energy losses during the transmission and distribution service phase")). In other words, stepping up the voltage enables the utility "effectively and efficiently to move the electric power over a long distance." (App 236a, ¶ 28-30).

During transmission and distribution, the voltage of the electricity is gradually stepped down by transformers within substations as the electricity nears the customer. (App 215a, ¶ 113-114; App 236a-237a, ¶ 33-34). Shortly before reaching customers, the voltage is stepped down to the level used by those

customers. For industrial or commercial customers, that is typically about 200-480 volts (App 229a, ¶ 66), but it could possibly be much higher. (App 172a, 77:8-21). For residential customers it is typically 120 to 240 volts. (App 229a, ¶ 65). Consequently, the voltage level of "usable" power is not a pre-determined scientific fact but is instead dependent on the customer.

II. Treasury's use-tax audit

Treasury conducted a use tax audit of Detroit Edison for the tax periods from January 1, 2003, through September 30, 2006. (App 75a, ¶ 2; App 114a). After the audit, Treasury adjusted Detroit Edison's tax liability based on Detroit Edison's failure to remit tax on property used in the process of transmitting and distributing electricity, including wires, poles, transformers, cables, and containers. (App 119a-121a; App 75a, ¶10). Treasury determined that Detroit Edison's generation of electricity is exempt "industrial processing" and allowed an exemption for property used at those facilities. But Treasury also determined that the process of transmission and distribution was not an exempt activity and property used in that process was taxable.

As a result of these adjustments, Treasury issued a notice of intent to assess in the amount of $11,020,506 in tax plus interest, which was later corrected upward to $14,046,249 in tax plus interest. (App 128a-129a). Detroit Edison requested an informal conference with Treasury, which was granted. However, Detroit Edison withdrew its request before any informal conference took place. (App 130a-131a). Treasury then issued a decision and order of determination acknowledging the

withdrawal and ordering issuance of a final assessment in an adjusted amount of $13,102,113.54 in tax plus interest based on a payment by Detroit Edison. (App 130a-131a). A final assessment in that amount followed. (App 132a).

PROCEEDINGS BELOW

I. Court of Claims

Detroit Edison paid the final assessment under protest, filed a separate refund claim with Treasury, and filed suit in the Court of Claims seeking a total of $19,566,235.70 plus additional interest. (App 79a, ¶ 43). Detroit Edison challenged the assessment, alleging that the "machinery and equipment" used in its Electric System, "including, but not limited to, transformers, high-voltage towers, cables, substations, poles, etc.," and other tangible personal property used in its operations were exempt under the industrial processing exemption. (App 75a & 80-81a at ¶¶ 10, 47-54, & 61). Detroit Edison similarly sought a refund on items not included in the assessment on which it had self-assessed tax based on the same exemption. (App 83a, ¶ 63). Detroit Edison did not seek to apportion the exemption.

Detroit Edison contended that its operations included "the generation, transmission and distribution of electricity." (App 75a, ¶ 7). It further asserted that while the production of electricity begins at the generating plant site, "[t]he electricity is not yet a finished product" as it "continues to be processed" by the alteration of the voltage and volt amp reactive levels of the electricity during transmission and distribution. (App 75a-56a, ¶¶ 8-9 & 12-13). Detroit Edison claimed that "until the electricity leaves the final transformer in a consumable

form," it is still engaged in manufacturing and entitled to the industrial processing exemption. (App 76a & 82a, ¶ 15 & 61).

Treasury responded that the industrial processing exemption applied only to the generation of electricity, which was completed at the factory. (App 138a-139a). Further, Treasury maintained that the voltage levels merely concern the delivery or "bulk transport" of the electricity and did not affect whether it was a "finished good." (App 138a-139a). Therefore, the exemption did not apply.

After a formal denial of its refund request, Detroit Edison amended the complaint. (App 94a-113a). Both parties subsequently filed cross motions for summary disposition under MCR 2.116(C)(10).

The Court of Claims granted Detroit Edison's motion in relevant part. In a written opinion, the Court acknowledged that where a specific exclusion applies, the exemption is not applicable. (App 47a). But the Court held that electricity production continued until the electricity reaches the customer's meter and therefore, because it was not a "finished good" until that point, the activity of transmission and distribution was "industrial processing." (App 48a & 52a). The Court determined that where property is concurrently used in both transportation and industrial processing, the exemption applies. (App 55a). The Court also held that Treasury's Rule 65 was invalid because the Legislature had not adopted the rule into the industrial processing statute when that statute was amended, ostensibly viewing this non-action as a legislative override of the rule. (App 56a-

57a). Accordingly, the Court ordered a refund of both the taxes assessed by Treasury and Detroit Edison's self-assessed taxes.

II. Court of Appeals

Treasury appealed. In a published decision, the Court of Appeals affirmed, holding that "DTE's machinery and equipment located outside its generation plants are used in the activity of converting and conditioning electricity by changing the quality, form, character, or composition of the electricity for ultimate sale at retail up until the time the electricity reaches its customers' meters, at which point it becomes a finished good." (App 70a). The Court further relied upon MCL 205.94o(3)(d) in support of its decision, holding that "the machinery and equipment in dispute are used to inspect, test, and control the quality of electricity as it flows through the transmission and distribution system. (App 70a).

In addressing the exclusion for "distribution" and "shipping" under MCL 205.94o(6)(b), the Court observed that "we have a situation in which machinery and equipment are concurrently used in a unified system for purposes of both distribution *and* industrial processing." (App 71a) (emphasis in original). Relying on case law from 1942, the Court held that in such situations, "the 'industrial processing' exemption applies to the machinery and equipment *in full*." (App 71a) (emphasis in original).

Moreover, the Court invalidated Treasury's administrative rule. While noting that Rule 65 "would clearly preclude the exemption sought by DTE," it determined that Rule 65 was merely an "interpretive rule." (App 72a). And

because the rule "conflict[ed] with the UTA and the industrial processing exemption *as construed by us today*," the Court held that "the provision is invalid and unenforceable." (App 72a) (Emphasis supplied).

STANDARD OF REVIEW

Statutory interpretation is a question of law that this Court reviews *de novo*. *Ford Motor Co v Dep't of Treasury*, 496 Mich 382; 852 NW2d 786 (2014). The Court also "review[s] *de novo* a Court of Claims decision on a motion for summary disposition." *IBM v Dep't of Treasury*, 496 Mich 642, 647; 852 NW2d 865 (2014).

Additionally, unique rules apply to the construction of tax exemptions. "The burden of proving entitlement to the exemption rests on the party asserting the right to the exemption." *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 165; 853 NW2d 310 (2014); *Elias Bros Restaurant v Treasury Dep't*, 452 Mich. 144, 150; 549 N.W.2d 837 (1996). "Exemption from taxation effects the unequal removal of the burden generally placed on [taxpayers] to share in the support" of government and exemptions are "the antithesis of tax equality . . . ." *Michigan Baptist Homes & Development Co v Ann Arbor*, 396 Mich 660, 669-670; 242 NW2d 749 (1976). Consequently, "because tax exemptions upset the desirable balance achieved by equal taxation, they must be narrowly construed" in favor of the taxing authority---here, the Department of Treasury—and against the taxpayer: Detroit Edison. *Wexford Med Group v City of Cadillac*, 474 Mich 192, 204; 713 NW2d 734 (2006); *Ladies Literary Club v City of Grand Rapids*, 409 Mich 748, 753; 298 NW2d 422 (1980).

ARGUMENT

I. Transmitting and distributing electricity is not "industrial processing."

The transmission and distribution of electricity is not "industrial processing" under the plain language of the Use Tax Act. The text of the exemption indicates that "industrial processing" ends when the "shipping" and "distribution" of a product begins. MCL 205.94o(6)(b). This is true for electric utilities as well as any other taxpayer. Moreover, under Treasury's administrative rule that specifically addresses utilities, property used in the transmission and distribution of electricity is taxable. Consequently, this Court should reverse.

A. The terms of the industrial processing exemption apply equally to each industry. There are no fact-specific exceptions to the statute's plain meaning.

The Court of Appeals' opinion improperly treated the industrial processing exemption as applying differently to electrical utilities than it does to all other types of manufacturing. The opinion crafted a broad exemption for Detroit Edison and other electrical producers based on its observation that in crafting the industrial processing exemption, "[t]he Legislature seemingly envisioned a simple manufacturing situation" and "[t]he case at bar does not present such a simple fact pattern." (App 71a).

This approach was mistaken. Both the history and context of the industrial processing exemption indicate that it is a limited exemption that applies equally to all industries.

By its terms, the industrial processing exemption is a sales and use tax exemption that applies to specified aspects of the manufacturing process. MCL 205.54t; MCL 205.94o. Originally a Department of Treasury regulation defining what constitutes a "sale at retail," the exemption developed from the concept of purchasing goods for later resale as part of a greater product. *Boyer-Campbell Co v Fry*, 271 Mich 282, 284-287; 260 NW 165 (1935). The exemption was narrowly applied to "goods which as ingredients or constituents go into and form part of tangible personal property sold by the buyer." (App 363a; 367a). But the exemption did not encompass items indirectly used by a manufacturer in creating its products, such as fuel, operating machinery, and other similar equipment. (App 363a; 367a).

Unlike industry-specific exemptions that have been allowed for custom shipbuilding, MCL 205.94(1)(j), agriculture, MCL 205.94(1)(f), publishing periodicals, MCL 205.94(1)(l), interstate transportation, MCL 205.94k(4), telecommunications, MCL 205.94q, radio and television broadcasting, MCL 205.94(m), and a variety of other industries, the industrial processing exemption was not written with any specific industry in mind. Rather, it has application to automobile manufacturing, *Mich Auto Research Corp v Mich Dep't of Treasury*, 222 Mich App 227, 229; 564 NW2d 503 (1997), food producing, *Elias Bros Rests v Treasury Dep't*, 452 Mich 144; 549 NW2d 837 (1996), developing pharmaceuticals, *Int'l Research & Dev Corp v Dep't of Revenue*, 25 Mich App 8; 181 NW2d 53 (1970), and producing methane gas. *Granger Land Dev Co v Dep't of Treasury*, 286 Mich App 601; 780 NW2d 611 (2009).

Since its adoption by Department regulation in 1933, the exemption has both been broadened and more clearly defined by exclusions and other additions to the Act. The text of the statute remained sparse when first enacted in the Use Tax Act, stating only that "property sold to a buyer for consumption or use in industrial processing" was exempt. 1937 PA 94, Sec. 4(g).

From that time on, the Legislature, the Department, and the Courts have engaged in line-drawing, identifying the exact parameters of the exemption. What the exemption covers was later expounded in detail in Treasury's Rule 40, Mich Admin Code R 205.90, which from 1944 to the present provided examples of specific equipment, activities, and industry applications of the act. Gradually over time, additional policy determinations were incorporated into the Act. 1949 PA 273 (App 346a) (excluding "tangible personal property permanently affixed and becoming a structural part of real estate"); 1971 PA 208 (App 348a) (further excluding office supplies, licensed vehicles, food preparation, certain services, etc.); 1987 PA 141 (App 350a) (including equipment used in computer-assisted manufacturing). And on the basis of similar legislative line-drawing, many of the specific inclusions and exclusions for both property and activities were written into the statute in 1999 when the Legislature incorporated much of Rule 40 into MCL 205.94o(3), (4), (5), & (6). 1999 PA 117 (App 351a-359a); Mich Admin Code 1979 R 205.90 (App 372a).

From this history, several important observations can be made about the exemption. First, because its terms are generically applicable to all industries, there is no fact pattern that justifies a judicial rewriting of the statute. Second, the

exemption is the product of many policy determinations made over time, which only heightens the importance of this Court's oft-repeated maxim that unambiguous statutes should be enforced as written, *Burise v City of Pontiac*, 282 Mich App 646; 766 NW2d 311 (2009), and that courts should not be in the business of re-thinking the wisdom of legislatively adopted policies. *Ambs v Kalamazoo Cnty Rd Comm'n*, 255 Mich App 637, 650; 662 NW2d 424 (2003) ("It is not the role of the judiciary to second-guess a legislative policy choice . . . ."). Third, the exemption does not encompass the entire manufacturing process but only limited aspects as have been allowed by the Legislature by law or Treasury through rule. And finally, where a specific fact pattern does require different treatment, it will be addressed—as is evident from the now 34 specific modifiers to the definition of "industrial processing." MCL 205.94o(3), (4), (5), & (6).

B. Per the plain language of MCL 205.94o, distributing electricity to the customer is not an exempt industrial process.

Turning to the plain language of the exemption, the transmission and distribution of electricity is not "industrial processing." It does not meet the general definition of the statute. And more importantly, the activity of conveying a product to the customer via "shipping" or "distribution" is specifically excluded from "industrial processing." MCL 205.94o(6)(b).

The statute exempts from the imposition of use tax "property sold to the following . . . (a) an industrial processor for use or consumption in industrial processing." MCL 205.94o(1). The act defines "industrial processing" as:

> "the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail or for use in the manufacturing of a product to be ultimately sold at retail or affixed to and made a structural part of real estate located in another state. Industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage." MCL 205.94o(7)(a).

And an "industrial processor" is one "who performs the activity" described in that definition. MCL 205.94o(7)(b).

But the definition of "industrial processing" does not stop there. Rather, in subsections (3), (4), (5), and (6) of the statute, the Legislature identified and adopted 34 specific modifiers identifying the activities and property that either do or do not qualify for the exemption. These modifiers demarcate the contours of "industrial processing"—regardless of whether the activity satisfies the definition of § 94o(7)(a).

The language of MCL 205.94o must be read in context and as a harmonious whole. *McCahan v Brennan*, 492 Mich 730, 739-740; 822 NW2d 747 (2012). And when a general definition in a statute conflicts with a specific modifier to that definition, the specific modifier trumps the general definition. *Evanston YMCA Camp v State Tax Comm'n*, 369 Mich 1, 8; 118 NW2d 818 (1962). Therefore, as the Court of Appeals has recognized, even if an activity is "industrial processing" under that definition, when a specified "exclusion" applies, it will take the activity outside of the exemption. *Granger Land Dev Co v Dep't of Treasury*, 286 Mich App 601, 608-610; 780 NW2d 611 (2009) (addressing the exclusion for "property permanently affixed and becoming a structural part of real estate" under MCL 205.94o(5)(a)).

Accordingly, meeting the definition of "industrial processing" is only the beginning of the analysis. The analysis is not complete until the Court determines whether any of the exclusions apply. And if an exclusion applies, then the activity is not "industrial processing."

1. The transmission and distribution of electricity is specifically excluded from "industrial processing" by the exclusion for "shipping" and "distribution."

By specifically excluding both the activities of "distribution" and "shipping" from the definition of "industrial processing," the Legislature has plainly indicated that industrial processing ends when the shipping and distribution of any product begins. This includes the transmission and distribution of electricity.

MCL 205.94o(6)(b) provides one of the many modifiers identifying the contours of "industrial processing." The subsection states concisely that "[i]ndustrial processing does not include the following activities: . . . (b) Sales, *distribution*, warehousing, *shipping*, or advertising activities." (Emphasis supplied). Because the terms "distribution" and "shipping" are not defined in the statute, each term must be given its plain meaning. *Haynes v Neshewat*, 477 Mich 29; 729 NW2d 488 (2007).

Under dictionary definitions, "shipping" refers to "the act . . . of transporting goods." *The American Heritage Dictionary, 2nd Collegiate Ed.* (1976), p 1131. In other words, "shipping" is part of the delivery of the product to the consumer. See, e.g., MCL 205.92b(e) (defining "delivery charges" to mean "charges by the seller for the preparation and *delivery to a location designated by the purchaser of tangible*

personal property," including "shipping"). In a complementary manner, "distribution" is "the process of . . . supplying goods, esp. to retailers." *American Heritage Dictionary*, at pp 410-411. Accordingly, "shipping" and "distribution" together create a general exclusion of the entire process of conveying the product to the consumer. Consistent with the general definition's use of the term "finished goods" to establish the completion of industrial processing, anything after the production of a good is not part of the industrial process. MCL 205.94o(7)(a).

These terms apply with equal force to the process of distributing and conveying electricity as they do to any other product. Electricity is recognized as a tangible commodity the sale or use of which is subject to tax. MCL 205.51a(q) (defining "tangible personal property" to include "electricity"); MCL 205.92(k) (same); *cf. Detroit Edison Co v State*, 298 Mich 259, 264; 298 NW 525 (1941) ("Steam is generated as a marketable commodity and sold as such . . . . for consumption . . . ."). Thus, the description of manufacturing applies to electricity no less than it does to other "tangible personal property."

Further, the word "distribution" is used in the act both to refer to the "transmission *and distribution* of electricity," which is taxed as a "service" under MCL 205.93a(1)(e), and even within the "industrial processing" exemption itself. MCL 205.94o(5)(a) (referring to "electrical distribution, to the point of the last transformer"). By using the word "distribution" to refer to "electrical distribution" within the same section that excludes "distribution" from the definition of industrial processing, the Legislature clearly intended for "distribution" under § 94o(6)(b) to

include "electrical distribution" as much as to the distribution of any other taxable good. *People ex rel Simmons v Munising Tp*, 213 Mich 629, 633; 182 NW 118 (1921) ("Identical language should certainly receive identical construction when found in the same act."); *US Fid Ins & Guar Co v Mich Catastrophic Claims Ass'n*, 484 Mich 1, 14; 795 NW2d 101 (2009) (noting that "[i]f the Legislature had intended the same meaning in both statutory provisions, it would have used the same word."). Had the Legislature intended otherwise, it could have easily used a more restrictive definition of "distribution" in § 94o(6)(b). See, e.g., *Petersen v Magna Corp*, 484 Mich 300, 347; 773 NW2d 564 (2009) ("If the Legislature had intended that *only* the employer pay a claimant's attorney fees, it could have easily said as much and presumably would have done so in much more direct language."). It chose not to do so.

Moreover, electrical distribution serves the same purpose as any other "distribution" system. The power lines and equipment that connect Detroit Edison's generating plants to its customers are the means by which Detroit Edison ships and distributes its electricity to customers. (App 184a, fn 2) (describing "distribution service" as "the established system *to deliver electricity* from the transmission system *to the end-use customer*" and describing "transmission system" as "the high-voltage, *bulk transport of power* from generators to a specific distribution system"). Therefore, the equipment Detroit Edison uses to ship (or "transmit" in the vernacular of the industry) and to distribute electricity does not qualify for the exemption. It is really that simple.

Detroit Edison and the Court of Appeals' opinion mistakenly rely on a different modifier, MCL 205.94o(3)(d), to assert that Detroit Edison was engaged in "quality control" throughout transmission and distribution and therefore engaged in industrial processing. This conclusion contradicts that provision's plain language.

MCL 205.94o(3)(d) states that "industrial processing includes the following activities: . . . (D) Inspection, quality control, or testing *to determine whether particular units* of materials or products or processes *conform to specified parameters at any time before materials or products first come to rest in finished goods inventory storage.*" (Emphasis supplied). In other words, the "inspection" or "quality control" applies to the spot-checking of "particular units" and must occur "before materials or products first come to rest in finished goods inventory storage."

That provision is inapposite here. The "quality control" alleged to be engaged in by Detroit Edison is of the electrical system not "particular units" of its "materials or products." Detroit Edison's alleged "quality control" is instead related to maintaining the levels of voltage of the electricity, (App 215a-217a, ¶ 120-123, 125, 130, & 137), which simply serves the purpose of enabling the utility to "effectively and efficiently to move the electric power over a long distance." (App 236a, ¶ 28-30). And even more telling, in the "simple manufacturing situation" envisioned by the Legislature, (App 71a), the "quality control" under § 94o(3)(d) must occur *before* "finished goods," and thus *before* "shipping" and "distribution." MCL 205.94o(6)(b). The two were not envisioned as a simultaneous occurrence.

Detroit Edison is not engaged in "quality control" within the meaning of the statute; it is engaged in transmitting and distributing electricity: "shipping" and "distribution." MCL 205.94o(6)(b). The equipment is ancillary to this purpose, and it is not exempt. See also MCL 205.94o(5)(i) (excluding property used to maintain a product after production). Accordingly, the Court of Appeals erred.

2. Because Detroit Edison has created a "finished good" once electricity has been produced, transmission and distribution is not within the general definition at § 94o(7)(a).

Moreover, Detroit Edison's transmission and distribution does not even meet the general definition of "industrial processing" at MCL 205.94o(7)(a). Electricity is legally a finished good when produced, and the science does not undermine this conclusion.

Under the general definition of industrial processing, the process ends when there is a "finished good," and electricity is a finished product once it becomes the tangible personal property that will be "sold at retail." MCL 205.94o(7)(a). After being produced at the plant, Detroit Edison has "generated" (or produced) "electricity," (App 210a, ¶ 71), and therefore "tangible personal property" as defined by the statute, MCL 205.51a(q); MCL 205.92(k) (defining "tangible personal property" to "include[e] electricity"), the sale or use of which is taxable. MCL 205.52(1); MCL 205.93(1). The electricity is at that point a "vendible" good, capable of sale. *Detroit Edison Co*, 298 Mich at 264. Everything else in transmission and

distribution is merely about the *preservation* and *delivery* of electric power—not its *production.*

There is no electricity when Detroit Edison burns coal (or harnesses a nuclear reaction) to make steam that turns a turbine. But once the shaft attached to the turbine spins inside the generator, electricity is generated. (App 210a, ¶ 71) (noting that the current created by the rotation of turbines "is the electric product as produced by the generator."); (App 235a, ¶25-26) (referring to the electricity that leaves the plant). After that point, Detroit Edison's task is simply to deliver the electricity it has just generated to its customers—to transmit and distribute it. (*Id.* at ¶ 23) ("Voltage and current are instrumental to *the delivery of energy*"). The product that will be sold to customers (electricity) has already been produced. (App 268a-272a) (describing the generation of electricity and distinguishing it from the delivery of electricity). Therefore, the electricity is legally a "finished product" as soon as it is generated.

Additionally, in relying on its scientists to assert that electricity is not a "finished product," Detroit Edison states the science inaccurately. The idea that plant-generated electricity cannot be used by any of its customers unless the voltage of the electricity is significantly decreased is not true. As Mr. Cook averred in his deposition testimony quoted by the Court of Appeals, large industrial customers can use electricity directly from high voltage transmission lines. (App 172a, 77:12-16);(App 70a). One of Detroit Edison's experts, Bruce Wollenberg, confirms this in his affidavit. (App 252a, ¶ 25) (indicating that high voltage electricity cannot be

used by "most" customers). Different customers use electricity at different voltages. (App 273a). *So whether electricity is a finished product under Detroit Edison's theory is not a matter of scientific fact – it simply depends on who Detroit Edison's customer is.*

It is also not true that it is physically necessary to increase and decrease electricity's wattage in order for electricity to be delivered to residential customers When Thomas Edison first began generating and delivering electricity to residential customers, he generated and delivered the electricity at a residential 110/220 voltage level. (App 279a & 284a). The result of delivering electricity at such a low voltage is that the electricity could not travel very far—customers had to be located within a mile or two of the generating plant. *Id.*

Electricity is merely "a flow of energy as a result of electron vibrations." (App 259a). The reason modern electricity generators deliver their electricity at a high voltage rate is merely to reduce electrical energy losses inherent to the transmission of electricity over long distances. (App 152a, ¶ 21; App 236a, ¶ 28-30; App 172a, 75:12-24). Increasing and decreasing the voltage does not change the nature of electricity—it simply makes it possible to deliver it to locations farther than a mile or two from the generator. (App 152a, ¶¶ 18-21).

Detroit Edison's only response to Mr. Cook's statement was a supplemental affidavit from Ewald F. Fuchs. Mr. Fuchs states that at the atomic level, electricity generation and transmission are the same process: both events endow tangible

electrons with voltage so that the electrons can "flow from the generation plant to the customer's meter." (App 240a-241a, ¶¶ 8, 15).

But Detroit Edison's other expert, Bruce Wollenberg, told the U.S. Supreme Court that the idea that electrons flow through transmission lines is "inaccurate and highly misleading." (App 301a). Instead, Mr. Wollenberg explained that the "'thing' that is transmitted by the wire conduits suspended from those high-tension towers one sees is *energy*, not electrons . . . [e]lectrons do not 'flow' – but *electric current* does." (App 302a). Mr. Casazza, who joined Mr. Wollenberg on the Supreme Court amicus brief, also flatly declares that "[often] electric current is described as a physical flow of electrons. It is not. The electrons do not flow." (App 259a).

Detroit Edison relied on Mr. Fuch's supplemental affidavit below to continually assert that electricity is actually just electrons being "processed" between the generation plant and the customer's location. But the premise upon which Detroit Edison based its argument is flawed. The electricity that generators produce and people buy is actually a flow of energy. The voltage levels applied to the energy are primarily to ensure that the energy can flow far instead of near. And the equipment Detroit Edison uses to preserve and maintain the flow of energy against its natural dissipation is explicitly excluded from industrial processing activity. MCL 205.94o(5)(i) (excluding from industrial processing all "[t]angible personal property used or consumed for the preservation or maintenance of a finished good . . .").

Moreover, in accepting Detroit Edison's "finished goods" theory, the Court of Appeals determined that electricity generators are a different breed of industrial processor justifying unique exemption treatment that other manufacturers cannot receive under the express language of the statute. In other words, the Court usurped the legislative function. See John F. Manning, *Textualism and the Equity of the Statute*, 101 Colum. L. Rev. 1, 18 (2001) (noting "statutory details may reflect only what competing groups could agree upon . . . accordingly, departing from a precise statutory text may do no more than disturb a carefully wrought legislative compromise.").

Further, Detroit Edison's assertions that electricity is not a finished good until the voltage is reduced to a "usable" level creates an enormous tax loophole. Following this logic, furniture or any other product that must be assembled after purchase is not yet a "finished good," and industrial processing continues until the customer completes assembly at his or her home. Indeed, according to Detroit Edison's logic, industrial processing continues in every office or home in the power cord of each computer, television, stereo, or electronic device, which contains components that convert electricity from 120 volts AC to a DC current. (App 161a at 32:20-35:12). This reasoning enormously expands the exemption, contrary to the rule that exemptions are to be strictly construed, *Wexford Med Group*, 474 Mich at 204, and cannot reflect the intent of the Legislature.

Detroit Edison does not meet the general definition of industrial processing. A "finished good" exists legally and scientifically at the generating plant, and industrial processing is concluded at that location. This Court should reverse.

C. Rule 65 has the force of law and precludes the exemption sought by Detroit Edison.

Additionally, the "transmission and distribution of electricity" does not qualify for "industrial processing" because Treasury's administrative rule concerning utilities provides that property used in transmission and distribution is not part of the manufacturing process and is taxable. Mich Admin Code R 205.115. This rule is a properly promulgated, "legislative" rule. Therefore, it is enforceable in itself and should be enforced as written.

1. The Court of Appeals' opinion got one issue right: Rule 65 clearly precludes the exemption.

Rule 65 directly states that "property consumed or used in the transmission or distribution of electricity" is "taxable." Mich Admin Code R 205.115(4). The rule notes that "[s]uch transmission or distribution starts at the place *where the product leaves the immediate premises from which it is manufactured.*" *Id.* (Emphasis supplied). The rule also contrasts the process of the "transmission or distribution of electricity" with "the process of manufacturing or generating electricity," which is deemed tax exempt. Mich Admin Code R 205.115(3).

As observed by the Court of Appeals, if applied, "Rule 205.115(4) would clearly preclude the exemption sought by DTE." (App 72a). The exact activity at

issue here is "the transmission and distribution of electricity" by a public utility as addressed by Rule 65. (App 69a) ("The question framed by the parties is whether industrial processing of electricity continues to occur once the electricity leaves a generation plant for purposes of transmission and distribution."); Mich Admin Code R 205.115(4). The rule explains that all "property used or consumed in" that activity is "taxable." *Id.* And Treasury's auditors concluded that the property at issue was taxable in reliance on that rule. (App 119a & 135a). Therefore, the rule applies and precludes the exemption.

2. As an APA-promulgated rule, Rule 65 is not "interpretive" but is "legislative" and is enforceable in itself.

Nonetheless, the Court of Appeals erred in refusing to apply Rule 65 because it inaccurately labeled the rule "interpretive" and thus non-binding. Further, the Court ignored the rule because it held that the rule conflicted, not with the plain language of the statute, but with *the Court's construction* of the statute. The Court was mistaken on both accounts.

The Court of Appeals opinion apparently failed to heed this Court's warning that "when courts are unmindful of th[e] differing functions [of an administrative agency], they also tend to muddle the distinct standards of review that apply to each." *SBC Mich v PSC (In re Complaint of Rovas)*, 482 Mich 90, 102; 754 NW2d 259 (2008). By imprecisely delineating the agency function at issue, the Court did precisely that and muddled the standard applicable to promulgated rules with the standard applicable to policy statements.

Rule 65 is not an interpretive rule or policy statement by Treasury. MCL 24.207(h). Rather, it is a legislative "rule" as defined by the Administrative Procedures Act based on an agency exercise of properly delegated, quasi-legislative power. MCL 24.207; *Rovas*, 482 Mich at 98-101.

The term "interpretive *rule*" is something of an oxymoron. In Michigan law, an "interpretive rule" refers only to "policy statements" by an agency that indicate "what the agency thinks a statute or regulation means." *Clonlara, Inc v State Board of Educ*, 442 Mich 230, 239 & 243; 501 NW2d 88 (1993). Those statements serve "to *advise* the public of the agency's construction of the law it administers." *Id.* at 243-244. But they need not be promulgated under the APA and have no practical consequence other than to publicly declare "how the office representing the public interest in enforcing the law will apply it." *Id.* at 244. They do not have "the force and effect of law but [are] merely explanatory." MCL 24.207(h).

For example, a "Revenue Administrative Bulletin" issued by the Department is merely an "interpretive rule." As this Court explained in *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13; 678 NW2d 619 (2004), "RAB 95-1 was not adopted under the Administrative Procedures Act, MCL 24.201 *et seq.*, and, therefore, does not have the force of law." *Id.* at 21 (citing *Danse Corp*). Interpretive rules like RABs may be relied upon by a taxpayer as it indicates the Department's official position, MCL 205.6a, but they are not law. *Catalina Marketing*, 470 Mich at 21; MCL 24.207(h).

In contrast, rules promulgated under the APA are "legislative," are "enforceable in and of themselves," and are given "the force and effect of law" by this Court. *Clonlara*, 442 Mich at 239-240; *Danse Corp v City of Madison Heights*, 466 Mich 175, 181; 644 NW2d 721 (2002). "Legislative rules" are "the product of an exercise of legislative power by an administrative agency, pursuant to a grant of legislative power by the legislative body." *Michigan Farm Bureau v Bureau of Workmen's Comp*, 408 Mich 141, 148; 289 NW2d 699 (1980); *Rovas*, 483 Mich at 98 (referring to rulemaking as a "quasi-legislative" power of executive agencies). These rules are intensely vetted as the promulgating "agencies must follow the notice-and-participation rule-making procedures contained in the APA." *Mich State AFL-CIO v Sec'y of State*, 230 Mich App 1, 6; 583 NW2d 701 (1998). As this Court has remarked, "[t]he Legislature has prescribed an elaborate procedure in order to 'ensure that none of the essential functions of the legislative process are lost in the course of the performance by agencies of many law-making functions once performed by [the Legislature].'" *Danse Corp*, 466 Mich at 183 (brackets in original).

The purpose of these "legislative rules" is to "fill in the interstices of the statute and presumably carry out its intent in greater detail." *Clonlara,* 442 Mich at 240. Because they are legally binding, a reviewing court "may not substitute its judgment of the content of a legislative rule . . . ." *Id.*

Under this analysis, Rule 65 is not merely a policy statement indicating "what [Treasury] thinks a statute or regulation means," *Clonlara*, 482 Mich at 239;

it is a legally binding "legislative" rule. *Mich State AFL-CIO*, 230 Mich App at 14-15. Rule 65 meets the APA definition of a "rule" as "an agency regulation, statement, standard, policy, ruling, or instruction of general applicability that implements or applies law enforced or administered by the agency . . . ." MCL 24.207. It has been promulgated consistent with APA procedures. MCL 24.243(1) (requiring rules to be promulgated); MCL 24.261 (stating that "[t]he filing of a rule under this act *raises a rebuttable presumption that the rule was adopted . . . . as required by this act.*") (emphasis supplied). Moreover, Detroit Edison has not at any time proffered any evidence to question whether APA procedures were complied with in promulgating Rule 65. It is thus "legislative."

Indeed, this Court recently affirmed this principle in peremptorily vacating a published Court of Appeals opinion that invalidated one of Treasury's promulgated administrative rules on the basis that it was merely "interpretive." *Discount Tire Co v Dep't of Treasury*, 494 Mich 875 (2013) (order vacating opinion & denying leave). Notwithstanding that decision, that Court repeated its error here, invalidating Rule 65 based on the same mistaken analysis.

Because Rule 65 is a "legislative rule," this Court has held that review involves a two-step analysis. *Rovas*, 482 Mich at 101. First, "[a] reviewing court must determine whether the Legislature . . . . properly delegated authority to the agency to promulgate the rule at issue." *Id.* "If the Legislature has properly delegated the rulemaking authority, then the only question before the court is whether the agency 'has exceeded its authority granted by the statute.'" *Id.*

There is no question here that the Legislature has delegated authority to Treasury. Nor has that authority been exceeded. The Revenue Act grants Treasury authority to promulgate rules under the APA "necessary to the enforcement of the provisions of tax and other revenue measures that are administered by the department." MCL 205.3(b). And the Legislature has also mandated under both the General Sales Tax Act and the Use Tax Act that "[t]he Department *shall promulgate rules to implement this act* pursuant to" the APA. MCL 205.59(2); MCL 205.100(2). These enabling provisions authorize Treasury to make "legislative rules." *Chrysler Corp v Brown*, 441 US 281, 302-303 (1979) (noting under the federal APA that "substantive" or "legislative-type" rules are "rules that 'implement' the statute"). Therefore, Treasury has authority to "fill in the interstices of the [Use Tax Act] and . . . . carry out its intent in greater detail." *Clonlara,* 442 Mich at 240.

Rule 65 "implements" and "fills in the interstices" of the Use Tax Act by addressing questions surrounding the taxation of a utility. In part, it delineates when manufacturing of electricity ends for the purpose of whether a utility may receive the "industrial processing" exemption on certain property. Mich Admin Code R 205.115(4). Although addressed in general terms applicable to all industries by MCL 205.94o(6)(b), the rule provides a specific application to *this* industry in what may otherwise be perceived as an "interstice" of the statute as a result of the inapplicability of general language like "finished goods inventory storage," MCL 205.94o(7)(a), to a product like electricity. Therefore, it properly "implements" the act as allowed by MCL 205.100(2) and is a binding rule.

Since Rule 65 is legally binding, the Court of Appeals was mistaken to believe that it could substitute its judgment for the rule. To do so violates separation of powers principles—enabling the judiciary to create law rather than interpret. *In Re Manufacturer's Freight Forwarding Co*, 294 Mich 57, 63; 292 NW 678 (1940) ("To declare what the law shall be is legislative . . . ."); *Rovas*, 482 Mich at 98 (noting that "one of the defining aspects of judicial power" is to interpret the law). Instead, this Court has admonished that a reviewing court "may not substitute its judgment of the content of a legislative rule . . ." *Clonlara*, 442 Mich at 240.

Yet that is exactly what the Court of Appeals did, invalidating the rule because it "conflicts with the UTA and the industrial-processing exemption *as construed by us today* . . . ." (App 72a) (emphasis supplied). The Court's decision clearly was not based on a conflict with the plain language of the statute. The Court claimed to "construe" the statute, but a court may not "construe" a statute where the language is plain and unambiguous. *People v McKinley*, 496 Mich 410, 415; 852 NW2d 770 (2014).

And there is no conflict. Rather, after rejecting the plain language of the statute by reasoning that this "fact pattern" was not the "simple manufacturing situation" envisioned by the Legislature, (71a), the Court created its own "construction" of the statute and then held the rule to violate *that*. In other words, it substituted its own judgment for the promulgated rule.

Further, the Court was wrong to conclude that the rule conflicts with the statute. By disallowing the industrial processing exemption for electrical

distribution, the rule is consistent with the statute's exclusion of "distribution" from "industrial processing." MCL 205.94o(6)(b). And nothing in the statute says, contrary to Rule 65, that the transmission and distribution of electricity "property consumed or used in the transmission or distribution of electricity . . . . *is exempt.*" The idea that the rule conflicts with the statute is therefore *solely* based on the Court of Appeals' erroneous "construction"—not the plain text of the statute.

3. Rule 65 has not been invalidated by implication.

Detroit Edison has argued that Rule 65 has been invalidated by the mere passage of time or by the Legislature's failure to adopt the rule as part of the amendment of the "industrial processing" statute. Neither argument has any merit.

A rule does not become invalid merely because of the passage of time. To the contrary, the APA creates a presumption that rules remain effective until rescinded. For instance, MCL 24.231(1) provided that rules which became effective prior to the enactment of 1969 PA 306 were to "continue in effect until amended or rescinded." Similarly, with only limited exceptions, "an agency may abrogate its rule only by rescission." MCL 24.247(2). The absence of action does not undermine a rule.

And the fact that MCL 205.94o was amended does not undermine the rule. It is evident from the history of Rule 40, Mich Admin Code R 205.90, that by 1999 PA 117, the Legislature largely adopted that rule. (App 354a-356a & 372a). Both Rule 40 and Rule 65 co-existed for decades prior to that amendment. (App 368a-374a). Thus, this legislative amendment could not have created a conflict between Rule 65 and the Act if there was no conflict between the two rules before the Rule 40 was

adopted into statute. Instead, it is evidence that there is no conflict between Rule 65 and the Act.

Nor should this Court presume that Rule 65 is ineffective because its text was not adopted as part of 1999 PA 117, when the existing Rule 40 was incorporated into the statute. Such an argument smacks of legislative acquiescence—the very kind of reasoning that Detroit Edison derides—as Detroit Edison is asking the Court to draw the negative inference that the rule has become inoperative merely because it was not adopted. Yet this Court has often observed that the "legislature legislates by legislating, not by doing nothing, not by keeping silent." *McCahan v Brennan*, 492 Mich 730, 749; 822 NW2d 747 (2012).

Moreover, the argument is a *non sequitur* because the rule at issue here is Rule 65 (the rule regarding utilities) and not Rule 40 (the rule regarding industrial processing). The Legislature may have considered and adopted much of Rule 40—the *industrial processing* rule—in revising the *industrial processing* exemption. But that says nothing about the validity of the *utilities* specific rule, Rule 65, which may not have been considered by the Legislature when the statute was amended.

Because there is no basis to invalidate the rule, and it clearly applies, Detroit Edison is not entitled to the exemption. Therefore, the Court of Appeals erred both in invalidating this rule and allowing the exemption.

II. If the Court applies the industrial processing exemption, it must be apportioned between taxable and exempt use.

If the Court finds that Detroit Edison is entitled to the industrial processing exemption *at all,* the Court must apply the plain language of MCL 205.94o(2), which requires the taxpayer to propose a reasonable method or formula to apportion between the taxable and exempt uses. Moreover, since Detroit Edison bears the burden of proving its entitlement to the exemption and it did not provide a "reasonable method or formula" to be "approved by the department," the Court must conclude that it has waived its ability to do so.

A. The Court of Appeals mistakenly relied on outdated law.

In determining that the industrial processing exemption applies to the machinery and equipment *in full,* (App 71a-72a), the Court of Appeals overlooked the fact that the cases it relied on have all been superseded by statute.

All three cases the Court cited in support of its page-long analysis on whether the exemption should be apportioned involved tax periods preceding April 1, 1999—the effective date of 1999 PA 117. Those cases had held that "[c]oncurrent taxable use with an exempt use does not remove the protection of the exemption." *Mich Milk Producers Ass'n v Dep't of Treasury,* 242 Mich App 486, 495; 618 NW2d 917 (2000); see also *Mich Bell Telephone Co v Dep't of Treasury,* 229 Mich App 200, 211-212; 581 NW2d 770 (1998) (allowing a full exemption "when the equipment involved is put to mixed use, but in a unified process."); *Mich Allied Dairy Ass'n v State Bd of Tx Admin,* 302 Mich 643, 649-651; 5 NW2d 516 (1942) (ruling that use in industrial

processing made property exempt "notwithstanding the fact that they are also put to another" taxable use).

But those statements were made in the context of a textually neutral statute that did not speak one way or the other to the issue of apportionment. Neither the agriculture exemption of former MCL 205.94(f) construed in *Michigan Milk Producers* nor the communications equipment exemption of former MCL 205.94(t) construed in *Michigan Bell* contained language addressing whether to apportion the exemption between taxable and exempt use when both existed. See MCL 205.94(f) & MCL 205.94(t), as amended by 1997 PA 194. And while it is evident that both the *Michigan Bell* and *Michigan Allied Dairy Association* predate the 1999 amendment, the *Michigan Milk Producers* case—although decided in 2000—similarly concerned tax periods before 1999 as to which the 1999 amendment was inapplicable. *Mich Milk Producers*, 242 Mich App at 487 (addressing "an audit for the period July 1, 1990, through December 31, 1993"); 1999 PA 117 (noting in Enacting Section 1 that "this amendatory act takes effect for all periods *beginning March 31, 1995*"). Thus, it may have been reasonable for those courts to come to the conclusions they did, but those case holdings have no applicability here.

With the passage of 1999 PA 117, the Legislature amended the industrial processing exemption to require apportionment between taxable and exempt use where property is put to a dual use. The Legislature declared in Enacting Section 1 that in determining the exemption "for periods beginning April 1, 1999, *the tax shall be apportioned.* This amendatory act clarifies that existing law as originally

intended *provides for a prorated exemption.*" 1999 P.A. 117, at Enacting Section 1 (emphasis supplied); (App 359a).

Accordingly, the law from the 1999 amendment onward has read that "[t]he tax levied under this act does not apply to property sold to the following *after March 30, 1999, subject to subsection (2)* . . . ." MCL 205.94o(1) (emphasis supplied). Subsection (2) prescribes that "[t]he property under subsection (1) is exempt *only to the extent that the property is used for the exempt purpose* stated in this section." MCL 205.94(2) (emphasis supplied). Further, "[t]he exemption is limited to the percentage of exempt use to total use *determined by a reasonable formula or method approved by the department.*" *Id.* (Emphasis supplied).

The tax periods at issue in this case are January 1, 2003, through September 30, 2006. (App 75a, ¶ 2). Thus, there is no question that the amendment enacted by 1999 PA 117 applies to this case.

The Court of Appeals determined that "the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e. distribution . . . ." (App 72a). But even though the Court cited to 1999 PA 117 in its opinion, the Court did not apportion between taxable and exempt usage. (App 71a-72a). Instead, the Court incorrectly ruled that the combination of taxable use and what it deemed to be exempt use meant that "DTE is entitled to the claimed 'industrial processing' exemption *in full* . . . ." (App 71a) (emphasis in original).

By overlooking the 1999 amendment to the industrial processing exemption and relying on cases that no longer are the law, the Court of Appeals committed reversible error. MCL 205.94o(2) requires apportionment.

B. Because Detroit Edison failed to request apportionment from Treasury or submit evidence to the trial court to support apportionment, the Court should deny the exemption.

Apportionment is plainly required by the statute. Yet since Detroit Edison has neither proposed nor supported—and cannot support—any apportionment formula to identify a discrete percentage of exempt use, this Court should reverse outright.

1. The plain language of § 94o(2) requires that an apportionment method may not be used unless approved by Treasury.

The burden of proving the percentage of exempt use is on Detroit Edison, as taxpayers always bear the burden to prove their entitlement to any exemption. *Andrie*, 496 Mich at 165. By MCL 205.94o(2), which "limit[s]" the exemption "to the percentage of exempt use to total use," the taxpayer likewise bears the burden of providing a "reasonable formula or method" for this apportionment. Further, the use of such "formula or method" for is contingent upon "approv[al] by the department." *Id.*

Because the Legislature has stated that the formula must be "reasonable" and "approved by the department," it has committed discretion to Treasury to determine the reasonableness of any proposed apportionment. *Cf. Rory v Cont'l Ins*

Co, 473 Mich 457, 475; 703 NW2d 23 (2005) (holding that language allowing the insurance commissioner to "disapprove" of a contract if "unreasonable" left such decision "within the sound discretion of the Commissioner."). On the basis of that discretion, Treasury's decision on apportionment must be upheld as long unless there is no rational basis for its determination. *Clarke-Gravely Corp v Dep't of Treasury*, 412 Mich 484, 489; 315 NW2d 517 (1982) (remanding to the tax commissioner "for a determination whether, in the exercise of his discretion, there exists any rational basis to refuse to accept" the taxpayer's amended return); *Guardian Indus Corp v Dep't of Treasury*, 198 Mich App 363; 499 NW2d 349 (1993) (noting that because consolidation of returns is discretionary, the courts "will uphold the [revenue] commissioner's decision not to allow consolidation . . . . unless there is no rational basis for it"). And the requirement that Treasury "approve" the formula at a minimum imposes an obligation on a taxpayer to propose such formula to the agency and requires agency consideration of any such formula before it is subject to judicial review. *Cf. Clarke-Gravely*, 412 Mich at 489.

2. Rule 40 similarly requires Detroit Edison to either prove to Treasury's "satisfaction" that apportionment is "equitable and practical" or lose the exemption all together.

Treasury's promulgated Rule 40 reinforces the plain language of § 94o(2) by likewise indicating that taxpayers must prove the reasonableness of any proposed apportionment method to Treasury's satisfaction. Mich Admin Code R 205.90(8). In pertinent part, Rule 40 states:

> [w]here the industrial processing areas or spaces are not separate and distinct from other departments or activities . . . the tax will apply to such property unless it can be determined and substantiated to the satisfaction of the revenue division, department of treasury that a percentage or other apportionment thereof is equitable and practical. [2014 AC, R 205.90(8).]

Thus, the rule confirms that the statutorily mandated agency "approv[al]" of the "reasonable[ness]" of the formula means that it must be demonstrated "to the satisfaction of the . . . . department of treasury" that apportionment is: (a) equitable; and (b) practical. *Id.*; MCL 205.94o(2).

As a promulgated rule, Rule 40 has the "force and effect of law." *Danse Corp*, 466 Mich at 181. The Court of Appeals has indicated as much on each occasion that it has addressed Rule 40. For instance, in *Escanaba Paper*, in an opinion joined by then-Judge Zahra, the Court of Appeals wrote that "Rule 40 is not simply an 'interpretive rule'" because Treasury "has been empowered to promulgate rules through the exercise of delegated legislative power." *Escanaba Paper Co v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals issued Nov 19, 2009 (Docket No 286144), at 6, fn 8 (App 374a). And finding that Rule 40 "does not conflict" with the statute but "filled the void" in the question at issue in that case, the Court in *Escanaba Paper* applied the rule as having "'the force and effect of law.'" *Id.* at 15-18 (quoting from *Clonlara*, 442 Mich at 239). The Court reached the similar conclusions in *K & S Industrial Services*. *K & S Industrial Services v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals issued Sept 27, 2012 (Docket No 305516), at 4-58 (App 366a-367a) (stating that Rule 40 that 'fills in a gap' in the statute and has "the force and effect of law").

Therefore, Rule 40 must be applied. And like the text of the statute, Rule 40 requires a taxpayer to prove to Treasury's satisfaction that apportionment is reasonable and practical.

3. Detroit Edison's failure to substantiate an apportionment means it loses the exemption entirely.

Although both MCL 205.94*o*(2) and Rule 40 require the taxpayer to propose how to apportion taxable and exempt use, Detroit Edison has not even attempted to meet its burden of proof in the five years since it was aware of the issue at the completion of Treasury's audit. It made no attempt to request apportionment with its separate refund claim. Detroit Edison's failure in this regard means that it is not entitled to the exemption at all.

Detroit Edison acknowledges that the machinery and equipment at issue is used in the transmission and distribution of electricity. (App 75a, ¶ 9); (App 119a-121a) (categorizing the property by account types). And the Court of Appeals remarked that "the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e. distribution . . . ." (App 72a). Thus, although Treasury does not agree that any of the equipment is entitled to the industrial processing exemption, it is undeniable that the equipment is also used in a taxable activity. Yet Detroit Edison has never submitted any calculations about "the percentage of exempt use to total use" to support its claim to exemption as required by law. MCL 205.94o(2).

Indeed, it cannot do so. The Court of Appeals referred to the distribution of electricity and what it determined was an exempt use as a "unified process or system"—a concept that Detroit Edison has championed. (App 72a); (App 75a, ¶ 10) (describing the electric system, including both generation and transmission and distribution as "an integrated, interrelated, and interconnected network"). All of the equipment at issue here is apparently used in distribution *at all times*. And because transmission and distribution is inextricably intertwined with the alleged "industrial processing" activities, the doctrines governing the interpretation of tax exemptions forbid Detroit Edison from obtaining the exemption. That is, if they cannot prove apportionment, then they cannot satisfy their burden to prove entitlement to the exemption. When it comes to tax exemptions, a "tie" goes to Treasury. *Ladies Literary Club*, 409 Mich at 753.

In line with the governing statute and case law, Rule 40 also precludes the exemption because it is not "practical" to separate the two functions. 2014 AC, R 205.90(8) ("the tax will apply to such property unless it can be determined and substantiated . . . that a percentage or other apportionment thereof is equitable *and practical.*") (emphasis supplied). If it is not practical to apportion use, then the whole property is taxable.

And it is not "practical" here both because "distribution" is occurring at all times and because any "industrial processing" resulting from changes to the voltage of the electricity is solely for the purpose of efficiently transmitting the electricity in order to minimize power loss. (App 236a, ¶ 28-30; App 172a at 75:12-24). The

principal purpose of the transformers is to assist in distribution so that power is not lost along the way as a result of resistance and other forces that may drain the electrical energy. (App 236a, ¶ 29; App 172a at 75:12-24). But these pieces of the system do not *create* or *manufacture* electricity. Accordingly, even the alleged "industrial processing" activity is an activity intended to promote distribution and delivery. And it cannot be segregated from the distribution process by time, cost, or any other measurable ratio.

Moreover, Detroit Edison's failure at the trial stage of the proceeding precludes it from attempting to cure this defect now for two reasons.

First, the case was decided on cross motions for summary disposition under MCR 2.116(C)(10). (App 63a). The Court Rules require parties to provide factual support for their positions at summary disposition, and it is not sufficient to promise to do so later. MCR 2.116(G)(4); *see also Maiden v Rozwood*, 461 Mich 109, 597 NW2d 817 (1999) ("The reviewing court should evaluate a motion for summary disposition under MCR 2.116(C)(10) by considering the substantively admissible evidence actually proffered in opposition to the motion . . . A mere promise is insufficient under our court rules."). Thus, it is too late for Detroit Edison to attempt to provide factual support for apportionment at this stage.

Second, Detroit Edison was actually required to submit its method of apportionment to Treasury *before litigation* so that it could be reviewed and "approved by the department." MCL 205.94o(2); see also 2014 AC, R 205.90(8) (requiring the method apportionment to be "determined and substantiated to the

satisfaction of the revenue division, department of treasury . . ."). A taxpayer may only litigate what has been submitted to and decided by Treasury. See MCL 205.22 (taxpayer must be "aggrieved" by a "decision . . . of the Department"). Therefore, because Detroit Edison has failed to submit any method of apportionment to Treasury before suit, the Court may not review this issue. *Cf. Mich Supervisors Union OPEIU Local 512 v Dep't of Civil Serv*, 209 Mich App 573; 531 NW2d 790 (1995) (administrative remedies must be exhausted before seeking judicial review).

For all of these reasons, Detroit Edison's failure to provide support for its apportionment of the exemption requires a reversal of the Court of Appeals' decision and the entry of judgment in Treasury's favor.

CONCLUSION AND RELIEF REQUESTED

The Court of Appeals improperly rewrote the industrial processing exemption to broadly exempt the means by which electrical utilities convey their product to the customer and to eradicate the apportionment provision of the statute. By the plain language of section § 94o(6) and Treasury's binding Rule 65, distribution is not industrial processing, and the concept of distribution applies with equal force to the transmission and distribution of electricity. Additionally, MCL 205.94o(2) unambiguously requires that when property is used in both taxable and exempt usage, the exemption must be apportioned based on "a reasonable formula or method approved by the department." Because Detroit Edison made no attempt to apportion, it has waived its ability to do so.

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Dated: November 24, 2014